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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NO. 627.

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner,

v.

WILLIAM FLACCUS OAK LEATHER COMPANY, Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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William Flaccus Oak Leather Company, respondent above-named, through its attorney, prays that the petition heretofore filed herein for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered in the above-entitled cause on September 13, 1940, be denied.

OPINIONS BELOW.

The memorandum opinion of the Board of Tax Appeals (R. 5) is unreported. The opinion of the Circuit Court of Appeals (R. 17) is reported in 114 F. (2d) 783.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered September 13, 1940 (R. 23). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Whether the gain arising from insurance payments for loss by fire of certain property, owned by the taxpayer, is a gain from the "sale or exchange" of a capital asset which may enter into the computation, under Section 117 (d) of the Revenue Act of 1934, of the deduction allowable for losses sustained by the taxpayer from sales or exchanges of other capital assets.

STATUTE AND REGULATIONS INVOLVED.

The relevant provisions of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 5-8.

STATEMENT.

The facts are correctly stated in the petition for certiorari, pages 2 to 4, inclusive.

REASONS FOR DENYING THE WRIT.

1. The decision below is only technically in conflict with the decision of the Court of Appeals of the District of Columbia in *Herder v. Helvering*, 106 F. (2d) 153. Here it was admitted that a fire loss and subsequent payment of a fire insurance policy thereon according to its terms do not constitute a sale or exchange apart from the applicable statutory definitions. But it was successfully contended that the Congress classified the

instant transaction as a sale or exchange. This point was not even mentioned in the *Herder* case.

In the presentation of the *Herder* case to the Court of Appeals of the District of Columbia, counsel for the taxpayer advanced a wrong reason for a right conclusion to this argument. The destruction of property and its compensation are not to be compared with the retirement of a bond, even though under local law this may have amounted to the payment of a liquidated claim. Congress specifically included the retirement of a bond as a sale or exchange thereof in Section 117(f) of the 1934 Act. This was after repeated Board cases had held such a transaction to be non-capital. *Douglas Fairbanks v. U. S.*, 306 U. S. 436. Observe, however, that although this is the view without a specific statute, the Congress specifically treats such retirement as a sale or exchange in Section 117(f) of the 1934 Act and subsequent Revenue Acts.

Counsel did not argue, in the *Herder* case, and, apparently, the Court did not consider, the proposition that the Congress classified a transaction like ours as a capital transaction (sale or exchange) in Section 112 and that we are bound by the classification. The only value of the *Herder* case is to remind us that Congress has now (1934 and subsequent Acts) classified retirement of bonds as a sale or exchange and this Court itself would now perforce decide the *Douglas Fairbanks* case exactly the opposite to its decision thereof under the 1926 and 1928 Acts. The Congressional classification is binding.

The full and only point here is that Congress has specifically classified destruction of property, and its compensation as a capital transaction treated as specifically provided in Section 112(f) rather than as in 112(a) of the Revenue Act of 1934 (Petitioner's Brief, pages 8 and 9). Out of the inclusiveness of Section

112(a), Section 112(f) has carved exceptions, including destruction (by fire or otherwise).

2. The cases of *Helvering v. Hammel,* No. 49 and *Electro-Chemical Engraving Co. Inc. v. Com.,* No. 62, October Term, 1940, cited in petitioner's brief (pages 4 and 5) as pending related questions, were both decided on January 6, 1941, and hold that a loss suffered from a foreclosure sale is a loss from a "sale" of a capital asset. Those decisions dispose of the case of *Com. v. Freihofer,* 102 F. (2d) 787 (C. C. A. 3), holding that a loss to the owner of land from foreclosure of a mortgage lien was not a loss from a "sale or exchange" under Section 117 of the Revenue Act of 1934.

3. The present cause is unimportant. The assets involved were used in taxpayer's business and were of a character subject to the allowance for depreciation. (Stip., par. 5, R. 4). Such depreciable assets are specifically excluded from classification as capital assets for 1938 and subsequent years. Revenue Act of 1938, Section 117(a); Internal Revenue Code, Section 117(a) (Appendix, *infra,* pp. 5-8). Thus the precise question here presented could not arise under the Revenue Act of 1938 or under subsequent revenue acts.

4. The decision of the Circuit Court of Appeals was correct, for the reasons stated in its opinion (R. 17-21).

CONCLUSION.

It is respectfully submitted that, for the foregoing reasons, the petition for certiorari should be denied.

JOHN A. MCCANN,
Attorney for Respondent.

January, 1941.

APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23. [U. S. C., Title 26, Sec. 21.]

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes * * * gains or profits and income derived from any source whatever. * * *

* * * * *

(e) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111. [U. S. C., Title 26, Sec. 22.]

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

[U. S. C., Title 26, Sec. 111.]

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange

of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

(1) *Property Held for Productive Use or Investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for Stock of Same Corporation.*— * * *

(3) *Stock for Stock on Reorganization.*— * * *

(4) *Same—Gain of Corporation.*— * * *

(5) *Transfer to Corporation Controlled by Transferor.*— * * *

(c) *Gain From Exchanges Not Solely in Kind.*—

* * * * *

(d) *Same—Gain of Corporation.*— * * *

* * * * *

(e) *Loss From Exchanges Not Solely in Kind.*— * * *

(f) *Involuntary Conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or in the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of

the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

* * * * *

[U. S. C., Title 26, Sec. 112.]

SEC 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

* * * * *

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

* * * * *

(f) *Retirement of Bonds, etc.*—For the purposes of this title, amounts received by the holder

upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. [U. S. C., Title 26, Sec. 101.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 117-1. *Meaning of capital assets.*—The term "capital assets" includes all classes of property not specifically excluded by section 117 (b). The term is not limited to stocks and bonds nor to property held for more than two years. In determining whether property is a "capital asset," the period for which held is immaterial.

ART. 117-2. *Limitations on capital gains and capital losses.*— * * *

Section 117 (d) provides a limitation on deductions for capital losses affecting all taxpayers including corporations, that is, losses from sales or exchanges of capital assets shall be allowed as deductions only to the extent of $2,000 plus the gains from such sales and exchanges. However, in the case of certain banks or trust companies, this limitation is subject to the modification provided in that section.

* * * * * *

ART. 117-4. *Application of section 117 generally.*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the permanent abandonment of the use of property (see article 23 (e)-3), or loss sustained as the result of corporate stock or debts becoming worthless.

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